Essentials of

Services Marketing

3rd Edition

12 Promoting Services AND EDUCATING CUSTOMERS

WIRTZ LOVELOCK

Learning Objectives

12.1 Recognize the important role customer loyalty plays in driving a service firm's profitability.

12.2 Calculate the life-time value (LTV) of a loyal customer.

12.3 Understand why customers are loyal to a particular service firm.

12.4 Know the core strategies of the Wheel of Loyalty that explain how to develop a loyal customer base.

12.5 Appreciate why it is so important for service firms to target the "right" customers

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Learning Objectives

12.6 Use service tiering to manage the customer base and build loyalty.

12.7 Understand the relationship between customer satisfaction and loyalty.

12.8 Know how to deepen the relationship through cross-selling and bundling.

12.9 Understand the role of financial and non-financial loyalty rewards in enhancing customer loyalty.

12.10 Appreciate the power of social, customization, and structural bonds in enhancing loyalty.

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Learning Objectives

12.11 Understand what factors cause customers to switch to a competitor and how to reduce such switching.

12.12 Know why loyalty programs and customer relationship management (CRM) systems are important enablers of delivering loyalty strategies.

12.13 Understand the part played by CRM systems in delivering customized services and building loyalty.

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Promoting Services and Educating Customers

12.1

Recognize the important role customer loyalty plays in driving a service firm's profitability.

The importance of service personnel

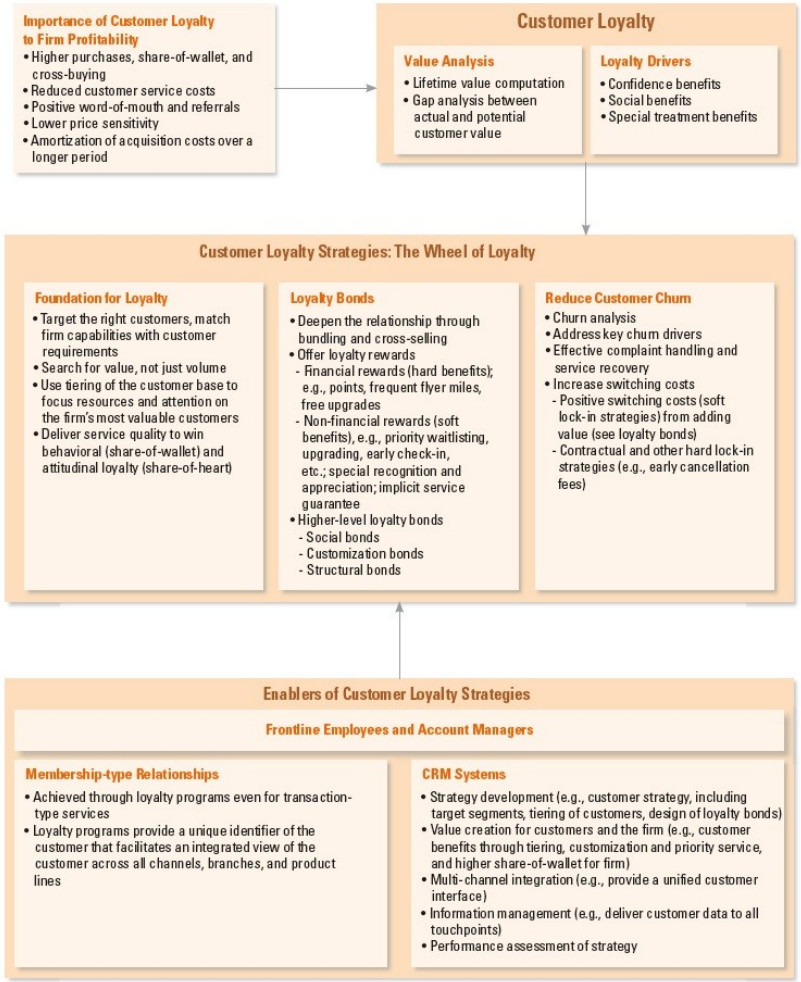
Importance of Customer Loyalty to Firm Profitability
• Higher purchases, share-of-wallet, and cross-buying
• Reduced customer service costs
• Positive word-of-mouth and referrals
• Lower price sensitivity
• Amortization of acquisition costs over a longer period
Customer Loyalty
Value Analysis
• Lifetime value computation
• Gap analysis between actual and potential customer value
Loyalty Drivers
• Confidence benefits
• Social benefits
• Special treatment benefits
Customer Loyalty Strategies: The Wheel of Loyalty
Foundation for Loyalty
• Target the right customers, match firm capabilities with customer requirements
• Search for value, not just volume
• Use tiering of the customer base to focus resources and attention on the firm's most valuable customers
• Deliver service quality to win behavioral (share-of-wallet) and attitudinal loyalty (share-of-heart)
Loyalty Bonds
• Deepen the relationship through bundling and cross-selling
• Offer loyalty rewards
- Financial rewards (hard benefits); e.g., points, frequent flyer miles, free upgrades
- Non-financial rewards (soft benefits), e.g., priority waitlisting, upgrading, early check-in, etc.; special recognition and appreciation; implicit service guarantee
• Higher-level loyalty bonds
- Social bonds
- Customization bonds
- Structural bonds
Reduce Customer Churn
• Churn analysis
• Address key churn drivers
• Effective complaint handling and service recovery
• Increase switching costs
- Positive switching costs (soft lock-in strategies) from adding value (see loyalty bonds)
- Contractual and other hard lock-in strategies (e.g., early cancellation fees)
Enablers of Customer Loyalty Strategies
Frontline Employees and Account Managers
Membership-type Relationships
• Achieved through loyalty programs even for transaction-type services
• Loyalty programs provide a unique identifier of the customer that facilitates an integrated view of the customer across all channels, branches, and product lines
CRM Systems
• Strategy development (e.g., customer strategy, including target segments, tiering of customers, design of loyalty bonds)
• Value creation for customers and the firm (e.g., customer benefits through tiering, customization and priority service, and higher share-of-wallet for firm)
• Multi-channel integration (e.g., provide a unified customer interface)
• Information management (e.g., deliver customer data to all touchpoints)
• Performance assessment of strategy

Figure 12.3 Organizing framework for managing relationships and building loyalty.

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The importance of customer loyalty

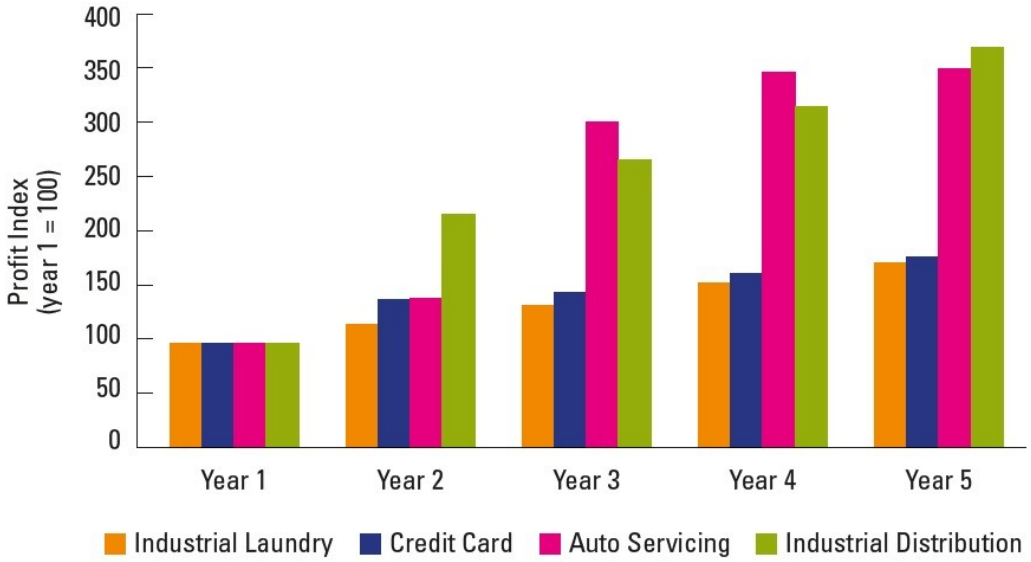

Figure 12.4 How much profit a customer generates over time.

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From Frederick F. Reichheld and W. Earl Sasser, Jr., " Zero Defections: Quality Comes to Services," © 1990 Harvard Business School.

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The importance of customer loyalty

- Customers become more profitable the longer they remain with a firm:
  - Increase purchases and/or account balances
    - Customers / families purchase in greater quantities as they grow
  - Reduced operating costs
    - Fewer demands from suppliers and operating mistakes as customer becomes experienced
  - Referrals to other customers
    - Positive word-of-mouth saves firm from investing money in sales and advertising
  - Price premiums
    - Long-term customers willing to pay regular price
    - Willing to pay higher price during peak periods

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The importance of customer loyalty

Why customers are more profitable over time.

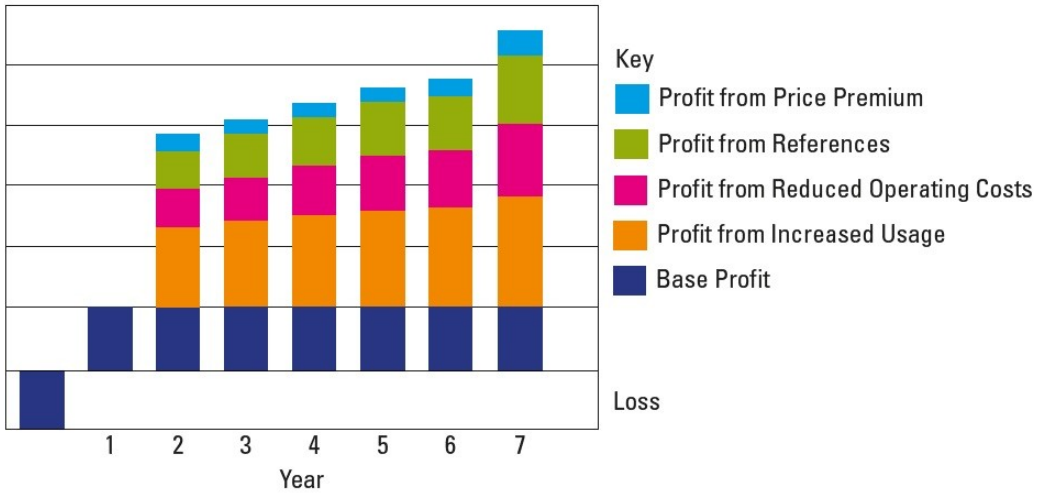

Figure 12.5 Why customers become more profitable over time.

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12.2

Calculate the life-time value (LTV) of a loyal customer.

Assessing the value of a loyal customer

- Must not assume that loyal customers are always more profitable than those making one-time transactions:
  - Large customers may expect price discounts in return for loyalty
  - Revenues don't necessarily increase with time for all types of customers
- Tasks:
  - Determine costs and revenues for customers from different market segments at different points in their custome
  - Predict f

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Assessing the value of a loyal customer

Measuring Customer Equity: Lifetime Value of Each Customer (1)

- Acquisition revenues less costs:
  - Revenues (application fee + initial purchase)
  - Costs (marketing + credit check + account set up)
- Projected annual revenues and costs:
  - Revenues (annual fee + sales + service fees + value of referrals)
  - Costs (account management + cost of sales + write-offs)

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Assessing the value of a loyal customer

Measuring Customer Equity: Lifetime Value of Each Customer (2)

- Value of referrals:
  - Percentage of customers influenced by other customers
  - Other marketing activities that drew the firm to an individual's attention
- Net Present Value:
  - Sum anticipated annual values (future profits)
  - Suitably discounted each year into the future

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12.3

Understand why customers are loyal to a particular service firm.

Why are customers loyal?

- Customers stay loyal when we create value for them
- Value can be created for customers through use of technology to control quality
  - Confidence benefits
  - Confidence in correct performance
  - Ability to trust the provider
  - Lower anxiety when purchasing
  - Knowing what to expect and receive

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Why are customers loyal?

- Social benefits
  - Mutual recognition and friendship between service provider and customer
- Special treatment
  - Better price
  - Discounts not available to most customer
  - Extra services
  - Higher priority when there is a wait

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12.4

Know the core strategies of the Wheel of Loyalty that explain how to develop a loyal customer base.

Why are customers loyal?

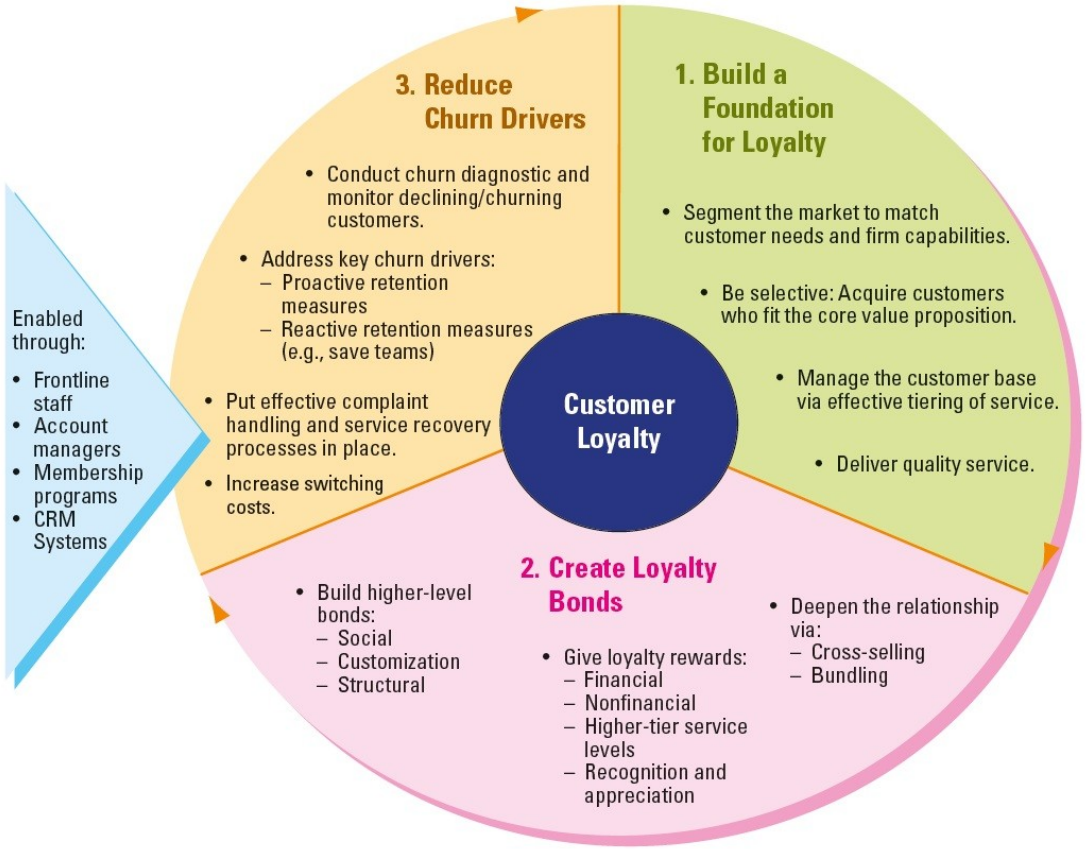
Enabled through:
• Frontline staff
• Account managers
• Membership programs
• CRM Systems
3. Reduce Churn Drivers
• Conduct churn diagnostic and monitor declining/churning customers.
• Address key churn drivers:
– Proactive retention measures
– Reactive retention measures (e.g., save teams)
• Put effective complaint handling and service recovery processes in place.
• Increase switching costs.
1. Build a Foundation for Loyalty
• Segment the market to match customer needs and firm capabilities.
• Be selective: Acquire customers who fit the core value proposition.
• Manage the customer base via effective tiering of service.
• Deliver quality service.
Customer Loyalty
2. Create Loyalty Bonds
• Build higher-level bonds:
– Social
– Customization
– Structural
• Give loyalty rewards:
– Financial
– Nonfinancial
– Higher-tier service levels
– Recognition and appreciation
• Deepen the relationship via:
– Cross-selling
– Bundling

Figure 12.6 The Wheel of Loyalty.

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12.5

Appreciate why it is so important for service firms to target the “right” customers.

Targeting the right customers

- Target the right customer and match them to what firm can deliver
  - How do customer needs relate to operations elements?
  - How well can service personnel meet expectations of different types of customers?
  - Can company match or exceed competing services that are directed at same types of customers?
- Focus on number of customers served as well as value of each customer:
  - Some customers more profitable than others in the short term
  - Others may have room for long-term growth
- "Right customers" are not always high spenders:

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12.6

Use service tiering to manage the customer base and build loyalty.

Managing the customer base

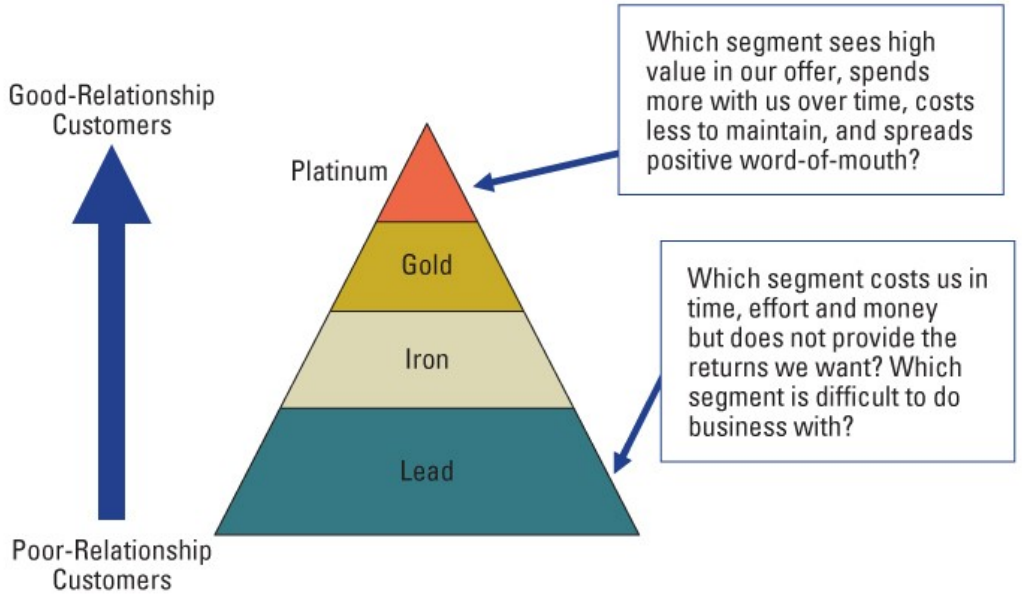
Good-Relationship Customers
Poor-Relationship Customers
Platinum
Gold
Iron
Lead
Which segment sees high value in our offer, spends more with us over time, costs less to maintain, and spreads positive word-of-mouth?
Which segment costs us in time, effort and money but does not provide the returns we want? Which segment is difficult to do business with?

Figure 12.8 The customer pyramid.

SOURCE

Valerie A. Zeithaml, Roland T. Rust, and Katherine N. Lemon "The Customer Pyramid: Creating and Serving Profitable Customers", *California Management Review* 43, no. 4, Summer 2001, Figure 1, pp. 118–142 Copyright © 2001 by the Regents of the University of California. Reprinted by permission of The Regents for electronic posting add" All rights reserved. This article is for personal viewing by individuals accessing this site. It is not to be copied, reproduced, or otherwise disseminated without written permission from the California Management Review. By viewing this document, you hereby agree to these terms. For permission or reprints, contact: cmr@haas.berkeley.edu.

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12.7

Understand the relationship between customer satisfaction and loyalty.

Customer satisfaction and loyalty

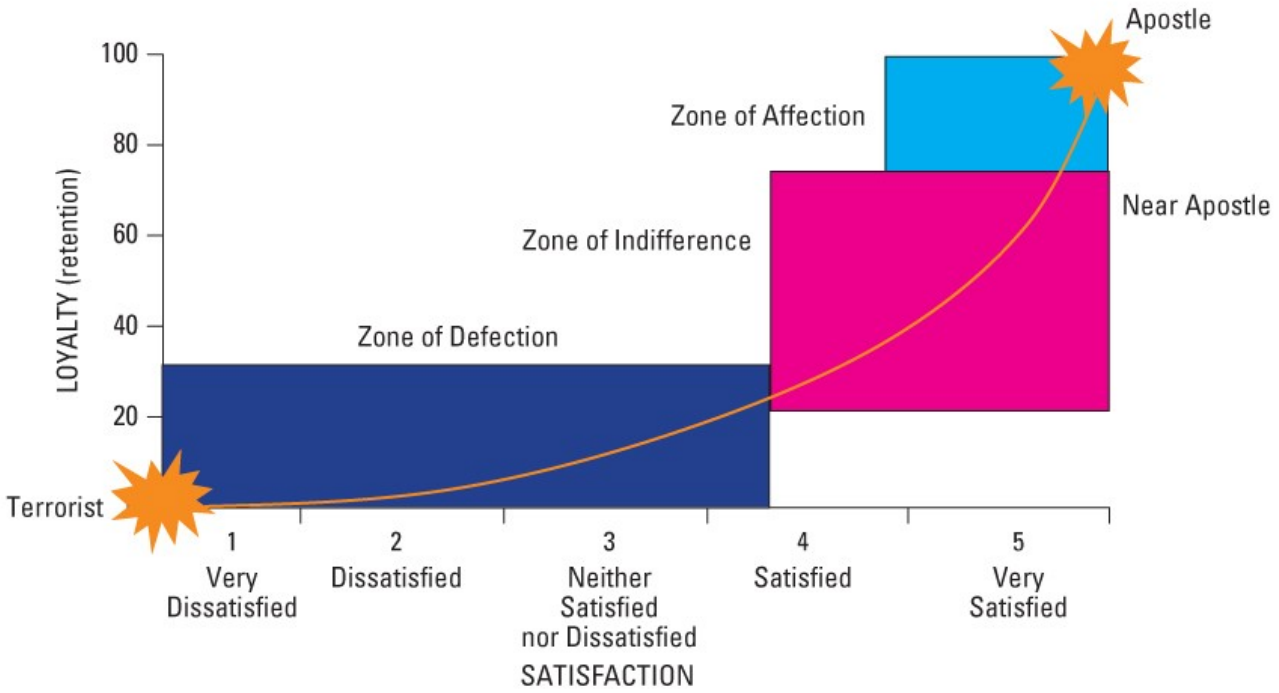

Figure 12.10 The customer satisfaction-loyalty relationship.

SOURCE

Adapted from Thomas O. Jones and W. Earl Sasser, Jr., "Why Satisfied Customers Defect," *Harvard Business Review*, November-December 1995, p. 91.

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12.8

Know how to deepen the relationship through cross-selling and bundling.

Cross-selling and bundling

- Bundling/cross-selling services makes switching a major effort that the customer is unwilling to go through unless extremely dissatisfied with service provider
- Customers benefit from buying all their various services from the same provider
  - One-stop-shopping, potentially higher service levels,

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Cross-selling and bundling

- Reward Based Bonds
  - Can be financial or non-financial bonds or a combination of both
  - Financial bonds
    - Discounts on purchases, loyalty program rewards (e.g. frequent flier miles), cash-back programs
  - Non-financial rewards
    - Priority to loyalty program members for waitlists and queues in call centers; higher baggage allo
      access to airport lounges for fre
  - Intangible rewards
    - Special recognition and appreci
  - Reward-based loyalty progr
    are relatively easy to copy a
    rarely provide a sustained
    competitive advantage

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Cross-selling and bundling

- Social Bonds
  - Based on personal relationships between providers and customers
  - Harder to and takes a longer time to build, but also harder to imitate and thus, better chance of retention in the long term
- Customization Bonds
  - Customized service for loyal customers
    - e.g. Starbucks
  - Customers may find it h to adjust to another service provide who cannot customize service

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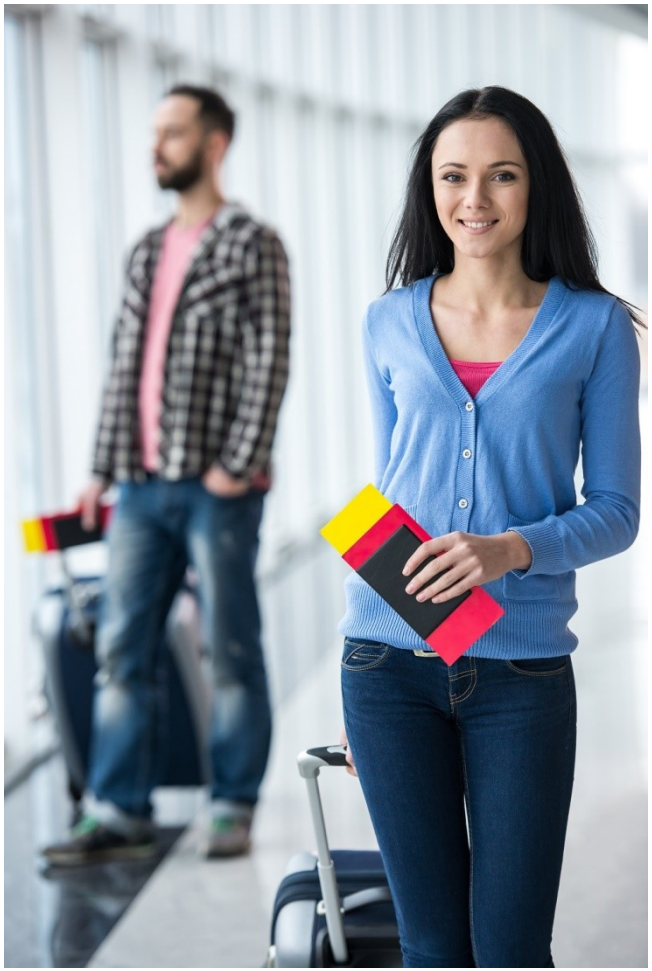
Cross-selling and bundling

- Structural Bonds
  - Mostly seen in B2B settings
  - Align customers way of doing things with supplier's own processes
    - Joint investments in projects and sharing of information, processes and equipment.
  - Can be seen in B2C environment too
    - Airlines: SMS check-in, SMS email alerts for flight arrival and departure times
  - Difficult for competition to draw customers away when they have integrated their way of doing things with existing supplier



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12.9

Understand the role of financial and non-financial loyalty rewards in enhancing customer loyalty.

Financial and non-financial loyalty rewards

- Financial Rewards: customer incentives that have a financial value
  - Brand loyalty versus deal loyalty
  - How buyers value rewards
  - Timing
- Non-financial Rewards: benefits that cannot be translated directly into monetary terms
  - Special recognition and appreciation of customers
  - Status benefits to customers in the top tiers

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12.10

Appreciate the power of social, customization, and structural bonds in enhancing loyalty.

Integrating teams across departments and functional areas

- Higher-level bonds offer sustained competitive advantage
  - Social Bonds
    - Based on personal relationships between providers and customers
    - Longer and harder to achieve
  - Customization Bonds
    - Achieved when the service provider succeeds in providing customized service to loyal customers
    - May be difficult for customers to adjust to another service provider who cannot customize the service
  - Structural Bonds
    - When customers to align their way of doing things with the supplier's own processes
    - Frequently seen in B2B settings; also found in B2C environments (e.g., car rental companies)

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12.11

Understand what factors cause customers to switch to a competitor and how to reduce such switching.

Reducing customers defections

What Drives Customers t Switch?

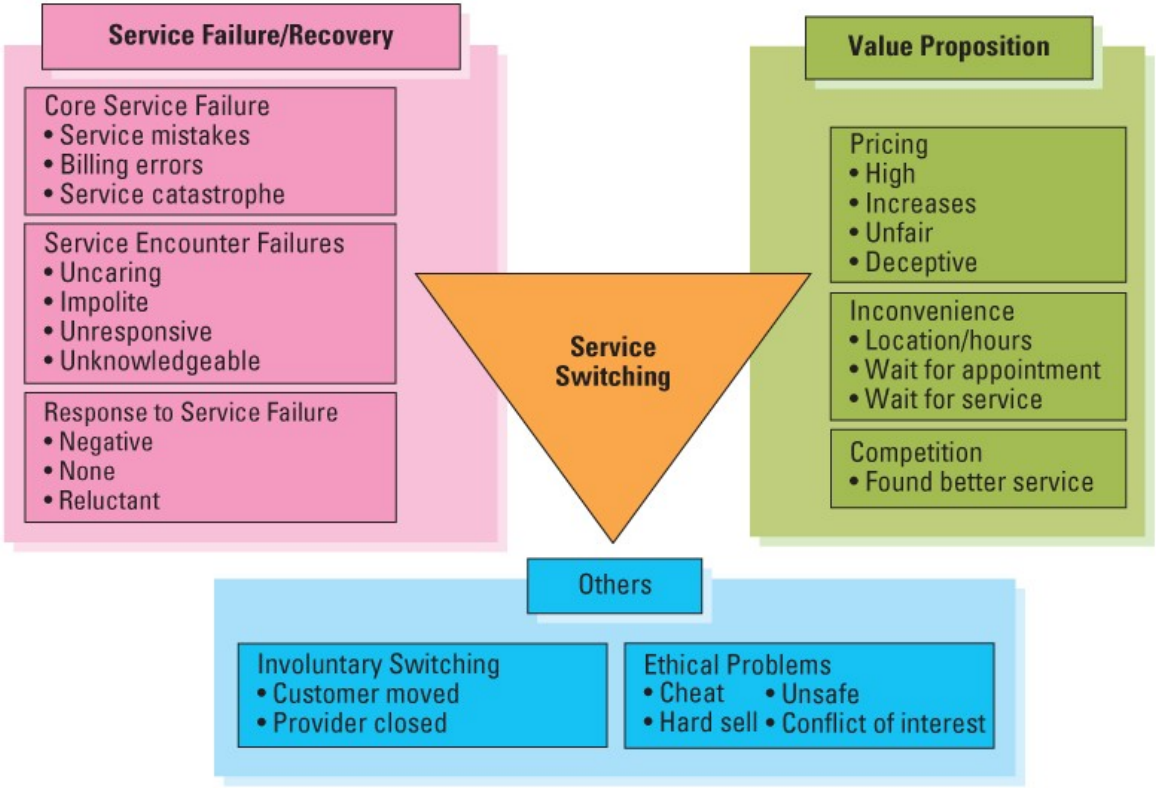

Figure 12.14 What drives customers to switch away from a service firm?

SOURCE

Adapted from Susan M. Keaveney, "Customer Switching Behavior in Service Industries: An Exploratory Study," *Journal of Marketing* 59 (April 1995), 71–82.

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Reducing customers defections

Address Key Churn Drivers

- Deliver quality service
- Reduce inconvenience and non-monetary costs
- Have fair and transparent pricing
- Industry specific drivers:
  - Cellular phone industry: handset replacement a common reason for subscribers discontinuing services – offer handset replacement programs
- Take active steps to retain customers:
  - Save teams: specially trained call center staff to deal with customers who want to cancel their accounts
  - Be careful about how save teams are rewarded

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Reducing customers defections

Other Ways to Reduce Churn

- Implement Effective Complaint Handling and Service Recovery Procedures
- Increase Switching Costs
  - Natural switching costs
    - e.g., Changing primary bank account; many related services tied to account
  - Can be created by instituting contractual penalties for switching
    - Must be careful not to be perceived as holding customers hostage
    - High switching barriers and poor service quality likely to generate negative attitudes and bad word of mouth

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12.12

Know why loyalty programs and customer relationship management (CRM) systems are important enablers of delivering loyalty strategies.

Loyalty programs and CRM systems as enablers of loyalty strategies

- Transactional marketing:
  - A transaction between a customer and a supplier is anonymous, with no long-term record kept and little or no mutual recognition
  - The focus is mostly on segmenting the market, matching customer needs with firm capabilities, and delivering high service quality
- Relationship marketing
  - The firm and the customer have an interest in deeper engagement and higher value-added exchange
  - Requires a membership-type relationship

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Loyalty programs and CRM systems as enablers of loyalty strategies

Table 12.2 Relationships with Customers.

Benefit	Type of Relationship between the Service Organization and Its Customers	
Nature of Service Delivery	**Membership Relationship**	**No Formal Relationship**
Continuous delivery of service	Insurance	Radio station
	Cable TV subscription	Police protection
	College enrollment	lighthouse
	Banking	Public highway
Discrete transactions	Long-distance calls from subscriber phone	Car rental
	Theater series subscription	Mail service
	Travel on commuter ticket	Toll highway
	Repair under warranty	Pay phone
	Health treatment for HMO member	Movie theater
		Public transportation
		Restaurant

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12.13

Understand the part played by CRM systems in delivering customized services and building loyalty.

CRM systems and delivering customized services and building loyalty

Common Objectives Of CRM Systems

- Customer perspective:
  - Unified customer interface that delivers customization and personalization
  - Vast service improvement and increase customer value
- Company perspective
  - Better segment, tier customer base and target promotion
  - Implement churn alert systems if customers are in danger of defecting

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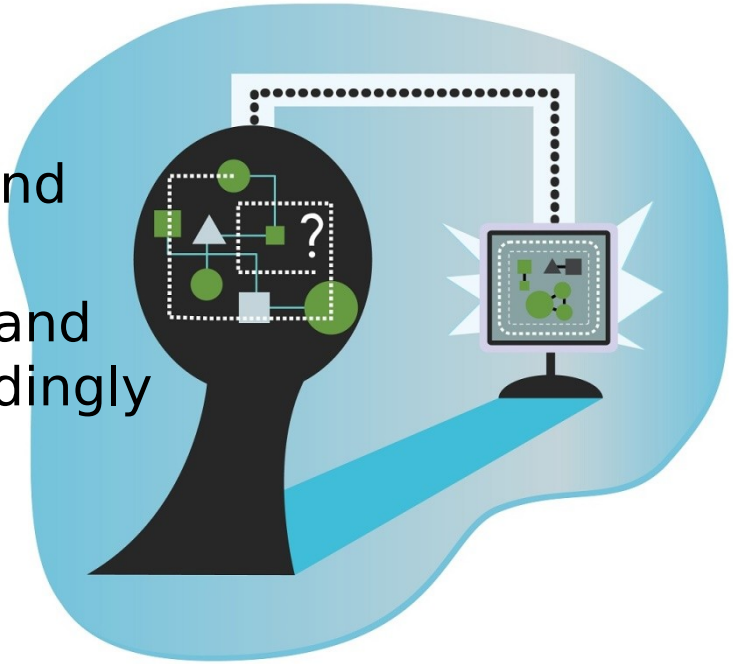
CRM systems and delivering customized services and building loyalty

Common Applications of CRM Systems (1)

- Data collection:
  - Customer data such as contact details, demographics, purchasing history, service preferences, and the like
- Data analysis:
  - Data captured is analyzed and categorized
  - Used to tier customer base and tailor service delivery accordingly



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CRM systems and delivering customized services and building loyalty

Common Applications of CRM Systems (2)

- Sales force automation
  - Sales leads and cross-sell and up-sell opportunities can be effectively identified and processed
  - Entire sales cycle from lead generation to close of sales and after-sales service can be tracked and facilitated through CRM system

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CRM systems and delivering customized services and building loyalty

Common Applications of CRM Systems (3)

- Marketing automation:
  - Mining of customer data enables the firm to target its market
  - Goal to achieve one-to-one marketing and cost savings, often in the context of loyalty and retention programs
  - Results in increasing the ROI on its marketing expenditure
  - CRM systems also allows firms to judge effectiveness of marketing campaigns through the analysis of responses

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CRM systems and delivering customized services and building loyalty

Common Applications of CRM Systems (3)

- Call center automation
  - Call center staff have customer information at their finger tips and can improve their service levels to all customers
  - Caller ID and account numbers allow call centers to identify the customer tier the caller belongs to, and to tailor the service accordingly
    - For exar ty in waiting loops.

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CRM systems and delivering customized services and building loyalty

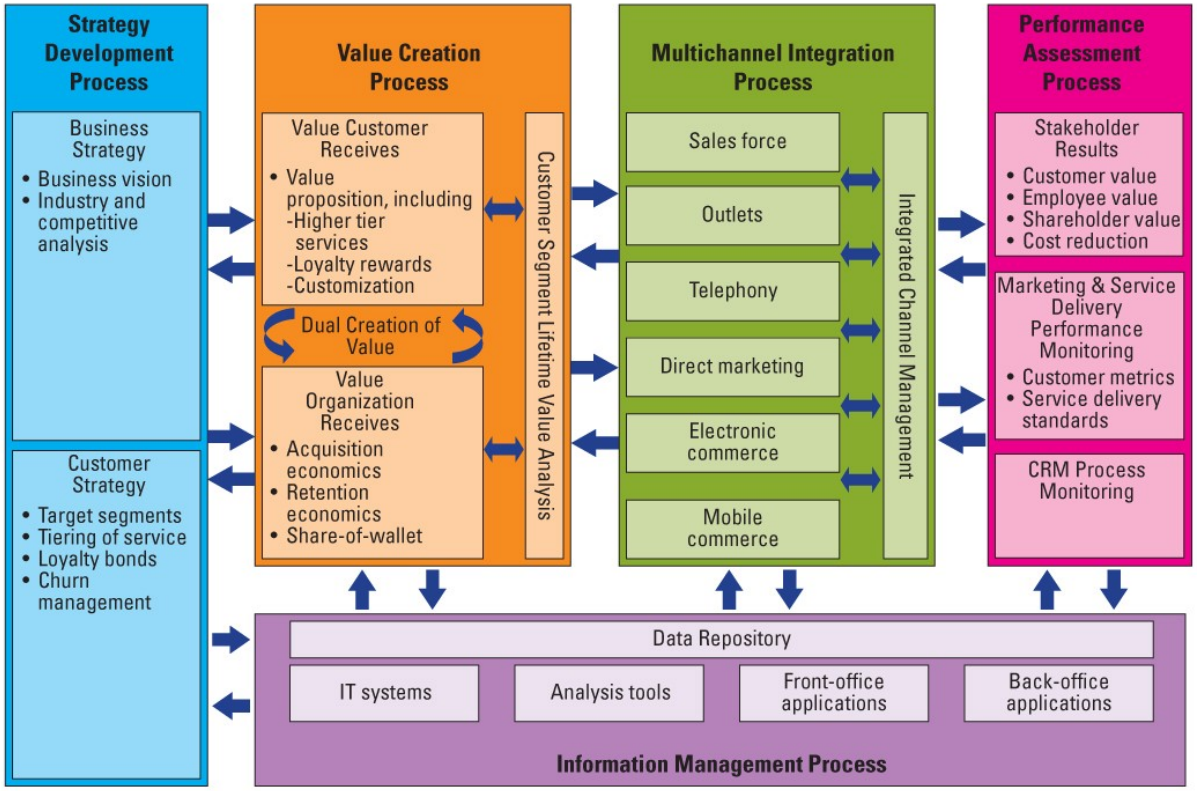

Figure 12.15 An integrated framework for CRM strategy.

SOURCE

Adapted from: Adrian Payne and Pennie Frow, "A Strategic Framework for Customer Relationship Management," *Journal of Marketing* 69 (October 2005): 167–176.

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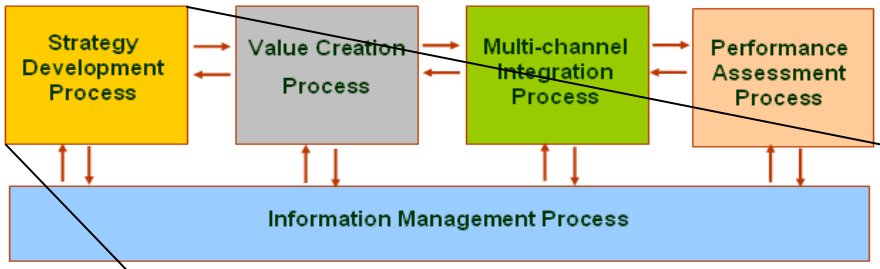

Strategy Development

- Assessment of business strategy
- Business strategy guides development of customer strategy

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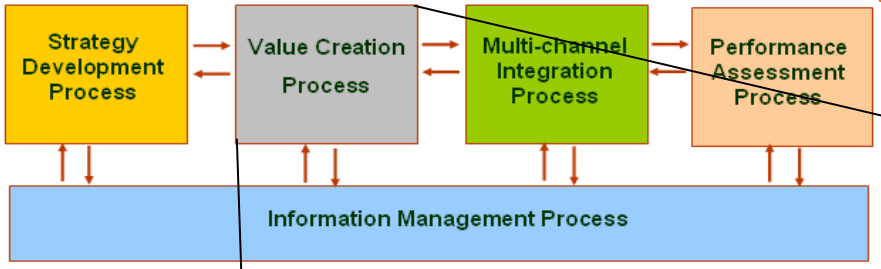

Value Creation

- Translates business and customer strategies into specific value propositions for both customers and firm
  - Customers benefit from priority, tiered services, loyalty rewards and customization
  - Company benefits from reduced customer acquisition and retention costs, and increased share-of-wallet
- Dual creation of value: customers need to participate in CRM to reap value from firm's CRM initiatives

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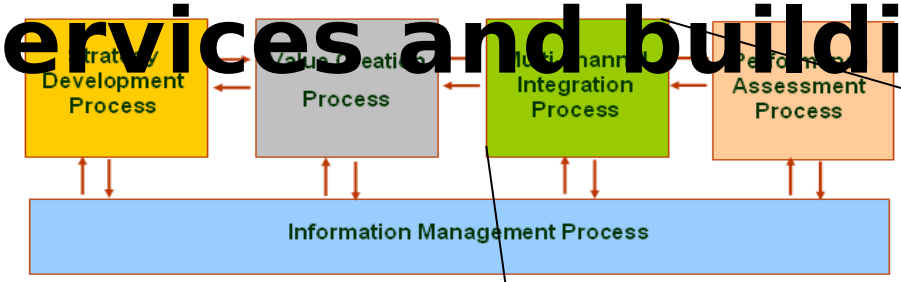
CRM systems and delivering customized services and building loyalty

services and building loyalty



Multi-channel Integration

- Serve customers well across many potential interfaces
- Offer a unified interface that delivers customization and personalization

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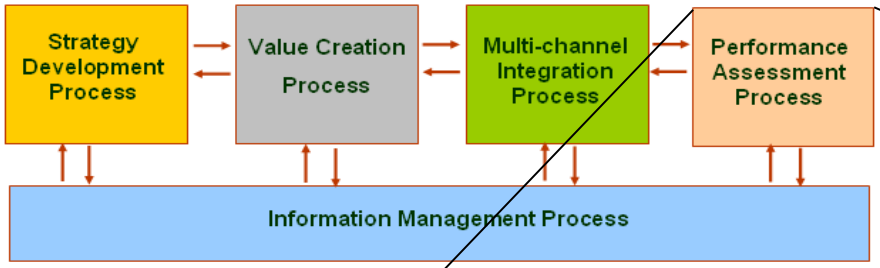
CRM systems and delivering customized services and building loyalty



Performance Assessment

- Is CRM system creating value for key stakeholders?
- Are marketing and service standard objectives being achieved?
- Is CRM system meeting performance standards?

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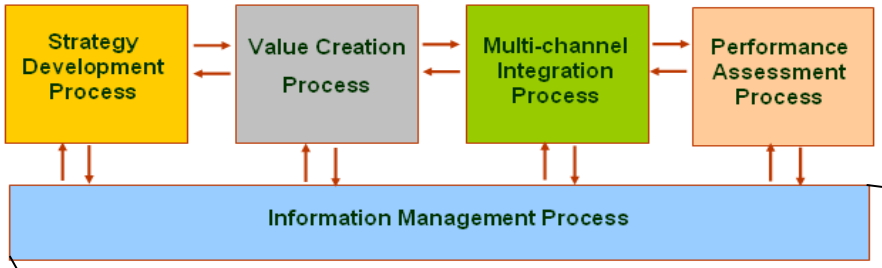
CRM systems and delivering customized services and building loyalty



Information Management

- Collect customer information from all channels
- Integrate it with other relevant information
- Make useful information available to the frontline
- Create and manage data repository, IT systems, analytical tools, specific application packages

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CRM systems and delivering customized services and building loyalty

- Unfortunately, there is a high failure rate for CRM implementations
- Common reasons for failures
  - Viewing CRM as a technology Initiative
  - Lack of customer focus
  - Not enough understanding of customer lifetime value (CLV)
  - Inadequate support from top management
  - Failure to reengineer business processes
  - Underestimating the challenges in data integration

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CRM systems and delivering customized services and building loyalty

- **How to get CRM right**
  - How should our value proposition change to increase customer loyalty?
  - How much customization or one-to-one marketing and service delivery is appropriate and profitable?
  - What is the increase in profit from increasing share-of-wallet with current customers? How much does this vary by customer tier and/or segment?
  - How much time and resources can we provide to CRM right now?
  - If we believe in customer relationship management, why haven't we taken more steps in that direction in past?
  - What can we do today to develop customer relationships without spending on technology?

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Thank You.